


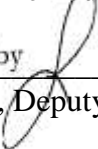
Item No. 11.1.6
Halifax Regional Council
June 25, 2013

TO: Mayor Savage and Members of Halifax Regional Council

SUBMITTED BY:

Original signed by 

Richard Butts, Chief Administrative Officer

Original Signed by 

Mike Labrecque, Deputy Chief Administrative Officer

DATE: June 7, 2013

SUBJECT: Proposed SAP Support Services Agreement with Province of Nova Scotia (PNS), Department of Finance

ORIGIN

Motion by Audit and Finance Standing Committee on January 30, 2013 directing staff to proceed with the recommendation to enter into a formal service level agreement with Province of Nova Scotia (PNS), Department of Finance to provide SAP Support Services.

LEGISLATIVE AUTHORITY

The authority to spend the amount detailed in this report can be found under Section 79(r) of the Halifax Regional Municipality Charter. The purchase would proceed by way of an intergovernmental sole source under the authority of Section 8 (11) A. (k) of Administrative Order #35, Procurement Policy. Because the purchase will extend beyond the end of the current fiscal year and the total expenditure commitment will exceed five hundred thousand dollars, under section 111(5) of the *HRM Charter* the proposed commitment will have to be approved by the Minister of Municipal Services.

RECOMMENDATION

It is recommended that Regional Council authorize the CAO to negotiate and execute an agreement for SAP support services with the Province of Nova Scotia, Department of Finance, in an amount not to exceed \$11.4M (plus the annual economic inflation adjustment) over a 10 year period, based on the proposed terms outlined in this report and any additional terms that are acceptable to the CAO but are not at odds with the terms detailed herein, in order to transition HRM to an outsourced SAP support model.

BACKGROUND

On January 30, 2013, staff presented a report to the Audit & Finance Standing Committee which recommended adoption of an alternative service delivery support model for SAP, the organization's Financial and HR system. This recommendation was based on a detailed analysis and due diligence exercise conducted in the preceding months which demonstrated a positive business case relative to the outsourcing of SAP support services to the PNS, versus continuing to provide these support services through an in-house service delivery model.

Based on the staff report and presentation, the Audit and Finance Standing Committee directed staff to negotiate a contract for SAP support services with PNS Department of Finance and return to Regional Council for approval.

Since this recommendation to the Audit and Finance Standing Committee, the Province has completed an agreement with IBM for SAP support services. The SAP CCC (Core Competency Centre) has been renamed Nova Scotia SAP Service Management (SAP SM) and this group assumes responsibility for delivering SAP services to clients with the support of IBM and the Provincial Infrastructure Service Management Division within the Office of the Chief Information Officer.

HRM and PNS have now completed transition planning and have confirmed mutually acceptable fees and key terms of an SAP support services contract, subject to Regional Council's approval and/or alternative direction. Other parts of the contract remain to be negotiated. An updated business case and a summary of the key terms of agreement being negotiated are presented in this report so that Regional Council is in a position deliberate and provide staff with direction and delegated authority.

DISCUSSION

Services To Be Governed

The agreement will govern three major services: SAP Basic Services, Major Enhancements and One-time Transition Services. SAP Basic Services include the provision of the physical computer infrastructure, network services, security administration, system maintenance, disaster recovery services, minor enhancements and SAP licenses. Major Enhancements include system changes and functional improvements to the SAP system. One-time Transition services include services provided by the PNS and its partners to transfer SAP from HRM to PNS and commission the system.

Service Levels to Be Provided

Service levels will be defined for on-going services provided as part of the SAP Basic Services. The service levels will be based on the service levels available to existing PNS clients and those that meet the needs of HRM.

Fees associated with the Services

Fees for SAP Basic Services will be based on the services to be provided to HRM. Fees for the SAP Basic Services will be comprised of a fixed component which does not depend on work load and a component which can vary at HRM's discretion. Fees are to be paid monthly and all fees with the exception of license fees will be subject to an annual economic inflation adjustment based on Conference Board of Canada inflation indices.

The fixed component of the SAP Basic Services fees will include the annual SAP license fee of approximately \$0.50M. This fee is charged to all SAP users and is based on the software owned by HRM. HRM currently pays this fee annually to the Province which manages SAP licenses on behalf of HRM.

The variable component of the SAP Basic Service fees will be comprised of the cost for the provision of the physical computer infrastructure, network services, security administration, system maintenance, disaster recovery services and minor enhancements. This fee component will be defined in advance in a fee schedule and will be payable in monthly installments according to the fee schedule. On an annual basis, HRM may elect to increase or decrease the SAP Basic Service fee and the corresponding amount of service provided. In this manner, HRM can align service needs and costs over time.

The variable component of the SAP Basic Service fee for the first full year of the contract will be \$0.71M. For each subsequent year, the variable component of this fee decreases, which reflects an expected efficiency gain in service delivery. The variable component of the SAP Basic Service fee payable in year ten of the agreement will be \$0.48M. In each year of the contract, HRM will owe the amount reflected in the SAP Basic Fee Schedule plus the annual economic adjustment unless HRM indicates the desire for an increase or decrease in the amount of services to be provided. HRM may select the mix of maintenance and improvement work performed within this services category. By changing the mix of work performed, HRM will be able to align work performed within this category to business needs without changes to the contract.

A second fee component is for Major Enhancement services. A rate table defines the fees associated with this service. At HRM's option, the PNS will undertake major enhancements to the SAP system using resources provided by PNS and its service provider IBM for the fees defined in the rate table. The defined rates are subject to the economic inflation adjustment. HRM, at its discretion, may request Major Enhancement services under the terms of this contract or may request these from another service provider.

The final fee component relates to One Time Transition Services. This fee is a 'time and material' based fee which reflects the work provided by PNS and its partners to transition SAP from HRM to PNS. The fee associated with the transition services will be approximately \$0.5M. HRM will not pay for work not performed. HRM will participate in this work.

Agreement Terms Summary

The agreement will consist of a Master Service Agreement (MSA) which defines the main terms and conditions of the agreement. The term of the agreement will be ten years with a three year renewal option if there is mutual agreement on an extension. The agreement will define the scope of services to be provided. A defined change process will allow for changes to the services in the event that HRM's service needs change, although this will come at an as-of-yet undefined cost to HRM.

The draft agreement contains provisions for the treatment of confidential and private data that are being negotiated but must ensure the service providers will meet HRMs responsibilities to maintain confidentiality and privacy of data.

Termination Provisions

The agreement will contain provision for termination in the event of material breach in the obligations of either HRM or the Province. The contract may also be terminated if the underlying SAP support services agreement between the Province and IBM is terminated.

Restructuring

In the event HRM restructures and requires fewer services under the agreement, a reduction of services and associated annual costs will be negotiated via the change process and HRM will pay the Province applicable wind down costs and a termination for convenience fee.

Business Case

The business case which includes all relevant costs to HRM for SAP support has been updated with costs obtained in the discussion with the Province and the most recent information available reflecting the internal costs of HRM. The updated business case figures are in line with those presented in the report to Audit and Finance Standing Committee on January 30, 2013. The business case continues to indicate that the SAP services agreement will lead to a more cost effective support mechanism for SAP with total costs of approximately \$1.3M per annum during steady state service delivery compared to \$1.7M for the in-source model. During the transition year, HRMs total SAP support costs are projected to be slightly lower for the out-source model at \$2.1M compared to the in-source model at 2.3M. Longer-term costs (over a six year period including transition costs) position the out-source model favorably at \$8.3M compared to \$10.8M for the in-source model.

	Transition Year	Steady State	Six Year Total
In-Source Model	\$2.3M	\$1.7M	\$10.8M
Out-Source Model	\$2.1M	\$1.3M	\$8.3M

The average annual steady state cost comparison highlights a compelling annual cost advantage of 27% (approx. \$0.4M) in favor of an out-sourced model over an improved in-source model. In addition the costs are on par with current costs and HRM can expect improved service delivery.

An improved out-source support model will better align SAP Support Services with HRM business needs and risk tolerance. In an out-sourced model, the HRM provides only strategic and business support functions while Functional Support and Technical Support functions would be provided through PNS.

Considering these factors, it is recommended that Regional Council authorize the CAO to enter into a contractual services agreement for SAP support services with the Province of Nova Scotia based on the proposed terms outlined in this report and any negotiated terms that are acceptable to the CAO but are not at odds with the terms detailed herein, and transition HRM to an outsourced SAP support model. Under this agreement, the SAP system will be re-located to the Provincial Data Centre under the oversight of SAP SM within the Department of Finance. Technical and Functional SAP support will no longer be provided directly by HRM staff.

By making this transition, HRM will better leverage its investment in SAP and enable focused attention to improving strategic and business support for SAP and avoid increased costs associated with a transition to an improved in-source model and the higher on-going costs associated with supporting this model.

FINANCIAL IMPLICATIONS

The total value of a services agreement for the 10 year term will be \$11.4M which is the sum of the annual SAP Basic Services fees which totals \$10.8M plus the One Time Transition Services Fee which will be approximately \$0.5M. HRM may at its option pay additional fees under the contract for Major Enhancements or if services are changed as per the change processes which result in increased fees. The economic inflation adjustment will increase annual fees by an amount to be determined by the Conference Board of Canada on an annual basis.

The annual expenditures for the out-source SAP service model in total including the negotiated SAP services contract are on par with current HRM costs; current costs are \$1.4M with costs under the new support model of \$1.3M.

COMMUNITY ENGAGEMENT

N/A

ENVIRONMENTAL IMPLICATIONS

N/A

ALTERNATIVES

As an alternative, HRM may elect to implement an improved in-source service delivery model. The effort to transition to an improved in-source model will require a projected one-time investment of \$0.89M over current annual support costs of \$1.43M. This investment is primarily needed to replace the aging technical infrastructure and to upgrade the software. Once transitioned, steady state costs are estimated to be \$1.71M or 20% over current annual costs. Total six year costs are projected to be \$10.8M.

In an in-source model, improvements are required to all major SAP support areas of strategic support, business support, technical support and functional support. However, in an out-source model, HRM is able to focus on providing the necessary improvements to strategic and business support functions which will ultimately lead to improved support for business functions.

Staffing changes are required at the technical support and functional support levels to implement the in-source service delivery model. These changes include the addition of a dedicated manager with responsibilities to direct functional work and ensure quality and alignment with business needs.

A second alternative is for HRM to RFP for the services of a service provider other than the PNS. HRM would not achieve the benefits of scale associated with the rates negotiated by PNS from IBM nor have access to software designs established through the PNS long standing relationships with other municipalities. The time required to initiate and complete an RFP for a different SAP Services supplier raises the risk to HRM due to its current aged infrastructure and may require HRM to invest in an improved infrastructure in advance of selecting a partner.

ATTACHMENTS

N/A

A copy of this report can be obtained online at <http://www.halifax.ca/council/agendasc/cagenda.html> then choose the appropriate meeting date, or by contacting the Office of the Municipal Clerk at 490-4210, or Fax 490-4208.

Report Prepared by: Jim Kirk, Manager, ICT Planning & CRM, 490-7297

Report Approved by: _____
Donna Davis, Chief Information Officer, 490-4417

Financial Approval by: _____
Greg Keefe, Director of Finance & ICT/CFO, 490-6308
